



[4830-01-p]

## DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 9702]

RIN 1545-BJ21

Allocation of Basis in All Cash D Reorganizations

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations and removal of temporary regulations.

SUMMARY: This document contains final regulations regarding the determination of the basis of stock or securities in certain reorganizations where no stock or securities of the issuing corporation is issued and distributed in the transaction. These final regulations clarify that only a shareholder that owns actual shares in the issuing corporation in such a reorganization can designate the actual share of stock of the issuing corporation to which the basis, if any, of the stock or securities surrendered will attach. These regulations affect corporations engaging in such transactions and their shareholders.

DATE: These regulations are effective on **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**.

FOR FURTHER INFORMATION CONTACT: Michael R. Gould, (202) 317-5363, or Kevin M. Jacobs, (202) 317-5024 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

### **Background and Explanation of Provisions**

## 1. Introduction

This Treasury Decision contains final regulations that amend the Income Tax Regulations (26 CFR part 1) under section 358(a) of the Internal Revenue Code (Code). In the case of certain reorganizations under section 368, section 358(a) and the regulations thereunder provide, in part, rules for determining a taxpayer's basis in stock or securities of an issuing corporation received without the recognition of gain or loss (permitted property), as well as rules relating to the basis of other property received in the reorganization. These final regulations clarify the rules under section 358(a) regarding the allocation of stock basis in a transaction that qualifies as a reorganization under section 368(a)(1)(D) (D reorganization) in which no permitted property is actually issued (All Cash D reorganization).

## 2. D Reorganizations Generally

Section 368(a)(1)(D) provides, in part, that a reorganization includes a transfer by a corporation (transferor corporation) of all or a part of its assets to another corporation (issuing corporation) if, immediately after the transfer, the transferor corporation or one or more of its shareholders (including persons who were shareholders immediately before the transfer), or any combination thereof, is in control of the issuing corporation, but only if, in pursuance of the plan, stock or securities of the issuing corporation are distributed under section 354, 355, or 356.

Under section 354(a)(1), a shareholder or security holder of the transferor corporation generally recognizes no gain or loss if the shareholder or security holder exchanges stock or securities of the transferor corporation, in pursuance of the plan of reorganization, solely for permitted property. Section 354(b)(1) provides that section

354(a)(1) is inapplicable to a D reorganization unless the issuing corporation acquires substantially all of the assets of the transferor corporation, and the stock, securities, and other properties received by the transferor corporation, as well as the other properties of the transferor corporation, are distributed in pursuance of the plan of reorganization. Further, section 356 provides, in part, that if section 354 would apply to an exchange but for the fact that property other than permitted property is also received, the recipient recognizes gain, but not in excess of the amount of money and fair market value of such other property.

### 3. All Cash D Reorganizations

On December 18, 2009, the IRS and the Treasury Department published final regulations (TD 9475) in the **Federal Register** (74 FR 67053) (2009 regulations) providing that the distribution requirement of section 368(a)(1)(D) and 354(b)(1)(B) is satisfied in the case of an All Cash D reorganization even though there is no actual distribution of permitted property by the transferor corporation, provided the same person(s) own, directly or indirectly, all of the stock of the transferor and issuing corporations in identical proportions. See §1.368-2(l)(2)(i). In such cases, assuming a value-for-value exchange between the transferor and issuing corporations, the issuing corporation is deemed to issue a nominal share of its stock in addition to the actual consideration exchanged for the transferor corporation's assets. If the issuing corporation provides the transferor corporation with no consideration or consideration having a value less than the transferor corporation's assets (bargain exchange), the issuing corporation is treated as issuing shares of its stock having a value necessary to result in a value-for-value exchange. The rules of §1.368-2(l) further provide that all

stock treated as issued, or deemed issued, by the issuing corporation to the transferor corporation is then deemed distributed by the transferor corporation to its shareholders and, if appropriate, further transferred through chains of ownership to the extent necessary to reflect the actual ownership of the transferor and issuing corporations.

The 2009 regulations also amended the regulations under §1.358-2(a)(2)(iii). Prior to being amended by the 2009 regulations, these regulations provided a two-step rule under section 358 for allocating the basis of stock or securities of a transferor corporation surrendered as a result of a bargain exchange by a shareholder or security holder (bargain exchange basis rule). First, a shareholder or security holder was generally treated as receiving the consideration actually received in the transaction and an amount of stock of the issuing corporation having a value equal to the difference in value between the stock or securities surrendered in the transaction and the consideration actually received. Second, the shareholder or security holder was treated as surrendering all of its stock and securities that it actually owned and was treated as owning of the issuing corporation in a reorganization under section 368(a)(1)(E) in exchange for the shares of stock and securities of the issuing corporation actually held immediately after the transaction.

The 2009 regulations added a new sentence after the bargain exchange basis rule that permitted a shareholder that was deemed to have received a nominal share of issuing corporation stock under §1.368-2(l) to, after adjusting the basis of the nominal share under the rules of §§1.358-1 and 1.358-2, designate a share of the issuing corporation's stock to which the basis, if any, of the nominal share would attach (nominal share basis designation rule).

#### 4. Temporary Regulations

On November 21, 2011, the IRS and the Treasury Department published temporary regulations (TD 9558) in the **Federal Register** (76 FR 71878) to amend §1.358-2(a)(2)(iii) of the 2009 regulations in response to an inappropriate interpretation of those rules. Certain taxpayers had taken the position that a shareholder of a transferor corporation who did not own any actual shares of an issuing corporation's stock immediately after the section 354 or section 356 exchange in a value-for-value All Cash D reorganization was permitted to designate another person's share of the issuing corporation's stock as the share to which the nominal share's basis could attach. For example, assume that corporation P owns all of the stock of corporations S1 and S2, and that S1 owns all of the stock of corporation S3. If S3 (the transferor corporation) transfers to S2 all of its assets (subject to liabilities) having a value of \$100x in exchange for \$100x of cash, S2 (the issuing corporation) would be deemed to issue a nominal share of its stock to S3 under §1.368-2(l)(2), provided the transaction otherwise qualified as a D reorganization. S3 would then be deemed to distribute the nominal S2 share to S1 in the section 356 exchange. Because S1 received a nominal S2 share but did not actually own any S2 stock, §1.368-2(l)(2) would require that the nominal S2 share be treated as distributed by S1 to P to reflect the actual ownership of S2 and P's basis in the nominal share would be its fair market value under section 301(d). In an attempt to avoid this result under similar circumstances, certain taxpayers took the position that S1 was permitted to, after allocating the basis of its S3 stock to the nominal S2 share under the rules of §§1.358-1 and 1.358-2, designate a share of S2 stock that was actually held by P to which S1's basis in the nominal S2 share would attach. These

taxpayers further took the position that such designation and allocation could occur immediately before the nominal S2 share was deemed (under §1.368-2(l)) to be further transferred through the chain of ownership to reflect the actual ownership of S3 and S2.

Under this interpretation, any built-in loss in the shares of transferor corporation stock (which the 2009 regulations allocated to the nominal share of issuing corporation stock) would be preserved even if a direct shareholder of the transferor corporation did not directly own stock of the issuing corporation. Taxpayers could thus avoid losing the built-in loss in the nominal share, which may have occurred as a result of the deemed transfer(s) of the nominal share through the chains of ownership to the actual shareholder(s) of the issuing corporation. In addition, the actual shareholder could then sell the share of the issuing corporation's stock to which the nominal share's basis was allocated and recognize a loss or a reduced amount of gain.

The IRS and the Treasury Department did not intend for the nominal share basis designation rule of the 2009 regulations to allow such an inappropriate allocation of basis and do not believe the 2009 regulations have ever supported such an allocation. The temporary regulations therefore clarified the application of the nominal share basis designation rule of the 2009 regulations. Specifically, the temporary regulations provided that, using the facts of the example described earlier in this section, because P (an actual shareholder of S2 (the issuing corporation)) is deemed to receive a nominal share of S2 stock described in §1.368-2(l), P must, after allocating and adjusting the basis of the nominal S2 share in accordance with the rules of §§1.358-1 and 1.358-2, and after adjusting the basis in the nominal S2 share for any transfers described in §1.368-2(l) (that is the transfer from S3 to S1 and from S1 to P), designate the share of

S2 stock actually held by P to which the basis, if any, of the nominal S2 share will attach. The purpose of the temporary regulations was to clarify that only a shareholder that owned actual shares of the issuing corporation's stock immediately after a value-for-value All Cash D reorganization could designate one of its actual shares of the issuing corporation's stock to which the nominal share's basis, if any, would attach.

A notice of proposed rulemaking (REG-101273-10) cross-referencing the temporary regulations was also published in the **Federal Register** (76 FR 71919) on November 21, 2011. No written comments were received in response to the notice of proposed rulemaking. In addition, no requests for a public hearing were received, and accordingly, no hearing was held.

## 5. Final Regulations

This Treasury Decision adopts the temporary regulations with clarifying changes. These changes include redesignating the paragraphs under §1.358-2(a)(2)(iii) to separate newly designated §1.358-2(a)(2)(iii)(A), the bargain exchange basis rule, and newly designated §1.358-2(a)(2)(iii)(B), the nominal share basis designation rule, and clarifying the language of these rules. The IRS and the Treasury Department do not intend any substantive changes to the rules of the temporary regulations.

The changes to newly designated §1.358-2(a)(2)(iii)(A)(1) and (2) were made to clarify that the deemed recapitalization under the second step of the bargain exchange basis rule occurs only after the stock treated as issued by the issuing corporation pursuant to §1.368-2(l) is held by a shareholder that actually owns issuing corporation stock. Thus, using the facts of the example described in section 4 of this preamble, except that the consideration provided by S2 is not \$100 of cash but only \$90 of cash,

because S1 (the shareholder of S3 (the transferor corporation)) does not actually own any stock of S2 (the issuing corporation), the basis of the S2 stock treated as issued under the first step of the bargain exchange basis rule that S1 receives in the section 356 exchange is determined under §§1.358-1 and 1.358-2 (without regard to the second step of the bargain exchange basis rule or the nominal share basis designation rule) and then further adjusted for the transfer to P described in §1.368-2(l) prior to the deemed recapitalization of the stock of S2 that P actually holds and is deemed to hold.

The numbering changes reflected in newly designated §1.358-2(a)(2)(iii)(A)(1), (2) and (B) were made to clarify that the nominal share basis designation rule applies in cases in which a nominal share of issuing corporation stock is deemed issued under §1.368-2(l). Additional changes were made under §1.358-2(a)(2)(iii) to emphasize that the nominal share basis designation rule applies only after an actual shareholder of the issuing corporation receives the nominal share pursuant to §1.368-2(l), and that such a shareholder must attach the nominal share's basis to a share of the issuing corporation's stock that the particular shareholder actually owns.

In addition, the analysis of Example 16 of §1.358-2(c) has been clarified to confirm that Corporation P must designate a share of Corporation Y stock to which the distributed nominal share's zero basis will attach. This designation of the share to which the basis of a nominal share must attach is relevant in various scenarios, including if an affiliated group files a consolidated return and must determine the particular share that is a successor asset for purposes of §1.1502-13. Finally, minor editorial changes were made to reflect the new paragraph designations under



§1.358-2(a)(2)(iii) and to make Examples 15 and 16 of §1.358-2(c) consistent with the clarifying changes adopted by the final regulations.

### **Special Analyses**

It has been determined that this Treasury Decision is not a significant regulatory action as defined in Executive Order 12866, as supplemented by Executive Order 13563. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because these regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking preceding these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small businesses, and no comments were received.

### **Drafting Information**

The principal author of these regulations is Michael R. Gould of the Office of Associate Chief Counsel (Corporate). However, other personnel from the IRS and the Treasury Department participated in their development.

### **Adoption of Amendments to the Regulations**

Accordingly, 26 CFR part 1 is amended as follows:

#### **PART 1--INCOME TAXES**

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 \* \* \*

Section 1.358-2 is also issued under 26 U.S.C. 358(b).

Par. 2. Section 1.358-2 is amended by:

1. Revising paragraph (a)(2)(iii).
2. Adding Example 15 and Example 16 to paragraph (c).
3. Revising paragraph (d).

The revisions and additions are as follows:

§1.358-2 Allocation of basis among nonrecognition property.

(a) \* \* \*

(2) \* \* \*

(iii)(A) For purposes of this section, if a shareholder or security holder surrenders a share of stock or a security in a transaction under the terms of section 354 (or so much of section 356 as relates to section 354) in which the shareholder or security holder receives no property or property (including property permitted by section 354 to be received without the recognition of gain or “other property” or money) with a fair market value less than that of the stock or securities surrendered in the transaction:

(1) Such shareholder or security holder shall be treated as receiving the stock, securities, other property, and money actually received by the shareholder or security holder in the transaction and an amount of stock of the issuing corporation (as defined in §1.368-1(b)) that has a value equal to the excess of the value of the stock or securities the shareholder or security holder surrendered in the transaction over the value of the stock, securities, other property, and money the shareholder or security holder actually received in the transaction. If the shareholder owns only one class of stock of the issuing corporation the receipt of which would be consistent with the economic rights associated with each class of stock of the issuing corporation, the stock

deemed received by the shareholder pursuant to the previous sentence shall be stock of such class. If the shareholder owns multiple classes of stock of the issuing corporation the receipt of which would be consistent with the economic rights associated with each class of stock of the issuing corporation, the stock deemed received by the shareholder shall be stock of each such class owned by the shareholder immediately prior to the transaction, in proportion to the value of the stock of each such class owned by the shareholder at that time. The basis of each share of stock or security of the issuing corporation deemed received and actually received shall be determined under the rules of this section. If and to the extent necessary to reflect the actual ownership of the issuing corporation immediately after the exchange to which section 354 (or so much of section 356 as relates to section 354) applies, an appropriate amount of the stock of the issuing corporation treated as issued to the shareholder or security holder in the exchange is deemed further transferred in accordance with §1.368-2(l) to reflect the actual ownership of the issuing corporation. Paragraph (a)(2)(iii)(A)(2) of this section is only applied to any shareholder of the issuing corporation after all of the deemed transfers pursuant to §1.368-2(l) are completed. The transferred shares' basis shall be adjusted for all deemed transfers required by §1.368-2(l).

(2) A direct shareholder of the issuing corporation that receives the shares deemed issued as part of the transaction, as described in paragraph (a)(2)(iii)(A)(1) of this section, shall then be treated as surrendering all of its shares of stock and securities in the issuing corporation, including those shares of stock or securities held immediately prior to the transaction, those shares of stock or securities actually received in the

transaction, and those shares of stock deemed received as described in paragraph (a)(2)(iii)(A)(1) of this section, in a reorganization under section 368(a)(1)(E) in exchange for the shares of stock and securities of the issuing corporation that the shareholder or security holder actually holds immediately after the transaction. The basis of each share of stock and security deemed received in the reorganization under section 368(a)(1)(E) shall be determined under the rules of this section.

(B) For purposes of this section, if an actual shareholder of the issuing corporation is deemed to receive a nominal share of stock of the issuing corporation as provided in §1.368-2(l), then that shareholder must, after allocating and adjusting the basis of the nominal share in accordance with the rules of this section and §1.358-1, designate the share of stock of the issuing corporation that it owns to which the basis, if any, of the nominal share will attach. If the shareholder does not actually own any shares of stock in the issuing corporation immediately after the exchange to which section 354 (or so much of section 356 as relates to section 354) applies, the nominal share of stock of the issuing corporation received by the shareholder in the exchange is deemed further transferred in accordance with §1.368-2(l) without applying the designation rule set forth in the first sentence of this paragraph until it is transferred to a person that actually owns stock in the issuing corporation. The transferred share's basis shall be adjusted for all deemed transfers required by §1.368-2(l).

\* \* \* \* \*

(c) \* \* \*

Example 15. (i) Facts. Each of Corporation X and Corporation Y has a single class of stock outstanding, all of which is owned by J, an individual. J purchased 100 shares of Corporation X stock on Date 1 for \$1.50 each, resulting in J having an aggregate basis in the stock of Corporation X of \$150. On Date 2, Corporation Y

acquires the assets of Corporation X for \$100 of cash, their fair market value, in a transaction described in §1.368-2(l). Pursuant to the terms of the exchange, Corporation X does not receive any Corporation Y stock. Corporation X distributes the \$100 of cash to J and retains no assets.

(ii) Analysis. Pursuant to §1.368-2(l), Corporation Y will be deemed to issue a nominal share of Corporation Y stock to Corporation X in addition to the \$100 of cash actually exchanged for the Corporation X assets. Corporation X will then be deemed to distribute the nominal share of Corporation Y stock to J in addition to the \$100 of cash actually distributed to J. Pursuant to §1.368-2(l), J, the actual shareholder of Corporation Y, the issuing corporation, is deemed to receive the nominal share of Corporation Y stock described in §1.368-2(l). J will have a basis of \$50 in the nominal share of Corporation Y stock under section 358(a)(1). Therefore, under paragraph (a)(2)(iii)(B) of this section, J must designate a share of Corporation Y stock to which J's basis of \$50 in the nominal share of Corporation Y stock will attach.

Example 16. (i) Facts. Each of Corporation X and Corporation Y has a single class of stock outstanding, all of which is owned by Corporation P. Corporation T has a single class of stock outstanding, all of which is owned by Corporation X. The corporations do not join in the filing of a consolidated return. Corporation X purchased 100 shares of Corporation T stock on Date 1 for \$1.50 each, resulting in Corporation X having an aggregate basis in the stock of Corporation T of \$150. On Date 2, Corporation Y acquires the assets of Corporation T for \$100 of cash, their fair market value, in a transaction described in §1.368-2(l). Pursuant to the terms of the exchange, Corporation T does not receive any Corporation Y stock. Corporation T distributes the \$100 of cash to Corporation X and retains no assets.

(ii) Analysis. Pursuant to § 1.368-2(l), Corporation Y will be deemed to issue a nominal share of Corporation Y stock to Corporation T in addition to the \$100 of cash actually exchanged for the Corporation T assets. Corporation T will be deemed to distribute the nominal share of Corporation Y stock to Corporation X in addition to the \$100 of cash actually distributed. Corporation X will have a basis of \$50 in the nominal share of Corporation Y stock under section 358(a). However, Corporation X is not an actual shareholder of Corporation Y, the issuing corporation. Therefore, Corporation X cannot designate any share of Corporation Y stock under paragraph (a)(2)(iii)(B) of this section to which the basis of the nominal share of Corporation Y stock will attach and Corporation X will be deemed to distribute the nominal share of Corporation Y stock to Corporation P as required by §1.368-2(l). Corporation X does not recognize the loss on the deemed distribution of the nominal share to Corporation P under section 311(a). Corporation P's basis in the nominal share it receives is zero, its fair market value, under section 301(d). Under paragraph (a)(2)(iii)(B) of this section, Corporation P must designate a share of Corporation Y stock to which the nominal share's zero basis will attach.

(d) Effective/applicability date. This section generally applies to exchanges and distributions of stock and securities occurring on or after January 23, 2006. However, paragraph (a)(2)(iii) and Examples 15 and 16 of paragraph (c) of this section apply to exchanges and distributions of stock and securities occurring on or after **[INSERT DATE OF PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER]**. See §1.358-2T(a)(2)(iii) and §1.358-2T(c), Examples 15 and 16, as contained in 26 CFR part 1, revised April 1, 2014, for exchanges and distributions of stock and securities occurring on or after November 21, 2011 and before **[INSERT DATE OF PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER]**; see §1.358-2(a)(2)(iii), as contained in 26 CFR part 1, revised as of April 1, 2011, for exchanges and distributions of stock and securities occurring on or after January 23, 2006 and before November 21, 2011.

**§1.358-2T [Removed]**

Par. 3. Section 1.358-2T is removed.

John Dalrymple

Deputy Commissioner for Services and Enforcement.

Approved: October 17, 2014

Mark J. Mazur

Assistant Secretary of the Treasury (Tax Policy).

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